National Energy Marketers Association

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

COMMONWEALTH OF VIRGINIA, ex rel.

STATE CORPORATION COMMISSION

In the Matter of Developing Consensus Recommendations on Stranded Costs	**Case No. PUE-2003-00062**

INITIAL COMMENTS OF THE NATIONAL ENERGY MARKETERS

The National Energy Marketers Association hereby submits its responses to the questions set forth in the Order Establishing Proceeding issued March 3, 2003, in the above-referenced proceeding.

The National Energy Marketers Association (NEM) is a national, non-profit trade association representing wholesale and retail marketers of energy, telecom and financial-related products, services, information and related technologies throughout the United States, Canada and the U.K. NEM's Membership includes wholesale and retail suppliers of electricity and natural gas, independent power producers, suppliers of distributed generation, energy brokers, power traders, and electronic trading exchanges, advanced metering and load management firms, billing and information technology providers, credit, risk management and financial services firms, software developers, clean coal technology firms as well as energy-related telecom, broadband and internet companies.

This regionally diverse, broad-based coalition of energy, financial services and technology firms has come together under NEM's auspices to forge consensus and to help resolve as many issues as possible that would delay competition. NEM members urge lawmakers and regulators to implement:

- Laws and regulations that open markets for natural gas and electricity in a competitively neutral fashion that bring suppliers and consumers together at the lowest possible cost;

- Standard rates, tariffs, taxes and operating procedures that unbundle competitive services from monopoly services and encourage true competition on the basis of price, quality of service and provision of value-added services;
- Accounting and disclosure standards to promote the proper valuation of energy assets, equity securities and forward energy contracts, including derivatives; and
- Policies that encourage investments in new technologies, including the integration of energy, telecom, digital communications and Internet services to lower the cost of energy and related services.

1. Define "stranded costs." Include in the definition a detailed listing of each stranded cost component. Is this definition applicable to all electric utilities operating in Virginia? If not, to which utility or utilities does it apply and why?

NEM submits that any determination of costs that are truly stranded must necessarily address the issue of whether the "unavoidable" costs at issue are, in fact, costs properly attributable to Provider of Last Resort-related services. Accordingly, NEM urges the Commission to implement embedded cost-based unbundled rates at the earliest possible time and to quantify the levels of migration and monitor utility mitigation efforts prior to developing just and reasonable methods to ensure utilities receive the appropriate revenue requirements based on the embedded costs associated with the actual services provided to migrating customers versus full sales customers versus POLR customers.

NEM recommends that any costs that are unavoidable because utilities must incur such costs to perform Provider of Last Related (POLR)-related services should be recovered through adjustments to the rates charged for POLR-related services. Utilities should not be permitted to recover revenue shortfalls through a transition surcharge in delivery rates based on a formula that assumes all unavoidable costs are caused by migration rather than by the necessity to provide POLR-related services. Any actual unrecovered costs or revenues lost that are not connected with the utilities' provision of POLR-related services and/or fully bundled sales service should be added to distribution rates in a competitively neutral fashion.

2. Define "just and reasonable net stranded costs." Provide a detailed explanation of how and why it differs from "stranded costs." Is this definition applicable to all electric utilities operating in Virginia? If not, to which utility or utilities does it apply and why?

The term "just and reasonable net stranded costs" requires a determination of whether or not the utilities have any stranded costs and whether those costs are offset by any stranded benefits. The qualifier "just and reasonable" also imparts a utility obligation to productively manage and mitigate net stranded costs.

3. Provide a methodology for calculating "just and reasonable net stranded costs." Be specific in providing the necessary steps, beginning with each component comprising gross stranded costs and each component offsetting this amount to reach a net amount.

NEM recommends that the methodology for calculating "just and reasonable net stranded costs" should be implemented after just and reasonable unbundled rates or shopping credits based on fully embedded costs have been implemented and actual migration has occurred. A reasonable period of time (e.g. one year or a migration rate of 25%) should be given to customers to comparison shop with shopping credits based on fully embedded cost-based unbundled rates (i.e. credits against utility bills) for contestable services.

Once a reasonable time (e.g. one year or 25% migration) has elapsed during which consumers are able to shop for one or more competitive services with embedded cost-based credits, then a calculation of the difference between the revenues that the utility would have received using fully embedded cost-based rates and the revenues actually received by the utility due to lost sales of specific services from the menu of competitive products, services, information and technology that each customer actually elects to purchase from the utility versus a competitive supplier should be compared to determine the maximum amount of potentially "qualifying revenue losses" that may be arguably recoverable, subject to the following qualifications:

1. The utility must show that the costs are material.
2. The utility must demonstrate that they have productively managed and reasonably mitigated costs in the subject areas.
3. The utility must not be earning in excess of their earnings/sharing cap, and
4. The utility must identify specifically which costs or revenue losses are a result of (a) the utility being required to provide POLR services and/or (b) the utility's need to provide fully bundled services to customers that do not migrate.

NEM also recommends that the methodology for calculating "just and reasonable net stranded costs" must be implemented in a manner that provides market participants with long term certainty as to the amount of the charge and the duration over which it will be imposed. For example, recalculation of the charge on a yearly basis will impose a large degree of uncertainty on market participants as to whether they can cost-effectively serve customers on a long-term basis. In order for competitive providers to make the infrastructure investments necessary to serve retail access customers, they must be provided with long-term certainty as to the viability of the Virginia retail marketplace.

Relatedly, a date certain should be established after which stranded costs are deemed fully recovered and the need for wires charges is eliminated. Competitive market participants and the consumers they wish to serve must be given a clear indication of the term of stranded cost recovery so they can form adequate and rational business plans with respect to serving the Virginia market.

4. Describe how stranded costs are recovered. Provide a methodology for calculating such recovery. Describe the recovery period.

NEM supports the competitively-neutral recovery of stranded costs, <u>if and when</u>, they occur. NEM also believes that net stranded costs should be recovered from all customers, whether they receive utility sales service or competitively provided service, on a competitively neutral basis. Recovering stranded costs solely from departing customers penalizes consumers who shop for lower priced energy and should not be permitted for a number of reasons as set forth below including: a) all customers benefit from robust retail energy price competition; b) competitively neutral charges are necessary to provide market participants with long term certainty to make investments in the Virginia market; c) if stranded cost charges are not assessed on a competitively neutral basis, inaccurate price signals will be sent to consumers; d) a competitively neutral stranded cost charge will eliminate the issue of uncertainty with respect to using retail open access load forecasts to set charge amounts; and e) a competitively neutral stranded cost charge will avoid the "retail access death spiral" effect.

a. All Customers Benefit from Robust Retail Energy Price Competition and Therefore All Customers Should Share the Cost

True price competition benefits all customers, not just those who shop for lower prices. The first and foremost benefit provided is the economic stimulus provided by economically efficient competitively priced energy as well as the ability to exercise choice beyond the regulated service they have traditionally received. It is unfair and unwise to penalize those customers who attempt to lower their energy costs as it defeats the entire purpose of permitting price competition in the first instance. If a charge applicable only to retail access customers is set too high, no one will be able to participate in the market. Assessment of stranded cost charges only against retail access customers will not only punish migrating customers, thereby slowing migration and the development of functional retail markets, but it will also encourage utilities to continue to invest in competitive services thereby further increasing future potentially "stranded" costs. In the end, society will pay a far higher transition cost the longer utilities remain in competitive lines of businesses.

b. Competitively Neutral Stranded Cost Charges Provide Marketers with Much Needed Long Term Certainty

Competitively neutral stranded cost charges will benefit the long-term development of the market by providing competitive marketers with the long-term certainty needed to justify the infrastructure investments of serving customers. For example, if stranded cost charges are set on a yearly basis and only imposed on retail access customers there will be a continuous risk that future stranded cost charges will make competitive offerings uneconomic. Without competitive neutrality, robust competition cannot evolve and the benefits that competition is intended to bring to Virginia cannot be realized.

c. A Stranded Cost Charge Billed Only to Customers Who Choose To Participate In Electric Customer Choice Masks Market Price Signals and Leads To Uneconomic Customer Purchases

Adding an incremental, non-market based charge to the cost of purchasing from market based sources and not to the cost of purchasing from the utility is clearly discriminatory and may cause customers to purchase energy from the utility when the utility's energy costs are higher. In other words, consumers will not be provided with a true comparison of utility and competitive service if the utility price-to-beat is comprised of commodity costs only and the competitive supplier's price is comprised of commodity costs and a stranded cost charge. The price signals will be obscured because of the stranded cost charge applied in a discriminatory fashion. The "one size fits all" product structures forces customers to pay for the inefficiencies embedded in regulated rates and the reliance on arduous regulatory proceedings will continue. This, in turn, will perpetuate economic inefficiency and higher than necessary energy costs for Virginia consumers. Putting in place a competitively neutral stranded cost recovery method will eliminate the risk that the utility's merchant service, which may not otherwise be an economically efficient choice, could displace competitively priced alternatives when those alternatives are a better or lower cost choice.

d. A Charge Applicable to All Customers Eliminates The Issue Of Uncertainty With Regard To ROA Load Forecasts Being Used To Set Charge Amounts

Given the very short history of electric competition and the dramatic impact that market price swings and utility surcharges can have on the economics of competitive choice, utility retail access load forecasting is at best arbitrary. Since the level of a per kWh charge can have dramatic impacts on customer choice, the utility would have an incentive to mis-forecast. The utilities and the Commission Staff have decades of experience in forecasting the utilities' total system load. Therefore, if the charge were applicable to all customers, the load forecast used to determine the charge per kWh would be very accurate and the probability of significant over- or under- collection would be greatly diminished. This increased certainty of collection should improve utility cash flows and mitigate skepticism on the part of capital markets and rating agencies.

e. Assessing Stranded Cost Charges Only Against Retail Access Customers Will Have a Detrimental Downward Spiral Effect

Utilization of a competitively neutral stranded cost charge will avoid the "retail access death spiral" effect that is inherent in a charge assessed against only retail access customers. Under this scenario, as customers return to utility service, the stranded cost charge increases as the number of customers against whom it can be assessed decreases. The result is to encumber the remaining retail access customers with disproportionately more costs thereby forcing their return to the utility's bundled service to avoid the imposition of the escalating stranded cost charge. This will cause further returns to the utility's bundled service, and ultimately the demise of the retail access program. Penalizing migrating customers can create a "retail access death spiral" which must be avoided.

5. Do the calculation and recovery methodologies described in responses to questions 3 and 4 produce (or are they likely to produce) over-recovery or under-recovery of just and reasonable net stranded costs? How should such over- or under-recovery be dealt with?

As a general matter, NEM believes that utility rates should be unbundled based on the utilities' fully embedded costs. To do otherwise will cause the utilities to incur much higher stranded costs. If utilities' rates reflect and utility customers pay less than fully embedded costs, customers will be paying an artificially low, subsidized price for competitively available services. If utilities' unbundled rates reflect and utility customers pay less than fully embedded costs, customers end up paying twice for these services. In conjunction, these two effects will slow customer migration and utilities will continue to incur costs for competitive services that may ultimately become stranded. In contrast, unbundled utility rates based on fully embedded costs will allow utilities to both quantify and, if properly mitigated, recover stranded costs within a reasonable time frame. It will also provide customers and competitors with true, accurate price signals that will permit meaningful price competition in the shortest possible time.

6. Requested Actions paragraph 1 of the LTTF Resolution requests that the work group develop consensus recommendations "consistent with the provisions of the Act." Explain how that phrase guides or possibly constrains the actions of the work group. Identify each section of the Virginia Electric Utility Restructuring Act, §§ 56-576 to -596 of the Code of Virginia, pertinent to such guidance or constraint. Additionally, explain each such section's significance in the context of definitions offered in response to questions 1 and 2 as well as in the methodologies proffered for calculating and recovering just and reasonable net stranded costs in response to questions 3 and 4.

The major statutory constraint faced by the workgroup in developing consensus recommendations is the requirement imposed by Section 56-583(B) that the wires charge be assessed to retail access customers only. Net stranded costs should be collected on a competitively neutral basis (see Response to Question 4 above). This provision prevents that result by penalizing customers that switch with a wires charge to collect stranded costs. NEM submits that the wires charge as currently instituted is a major barrier to competitive entry and should be reexamined consistent with the Commission's authority, vested in Section 56-596, to, "take into consideration, among other things, the goals of advancement of competition and economic development in the Commonwealth."

7. Provide copies of any study or studies undertaken to define and/or calculate stranded costs for any Virginia electric utility.

N/A

8. Provide any additional comments on the issues raised by Requested Actions paragraphs 2 and 3 of the LTTF Resolution.

N/A

NEM appreciates this opportunity to comment on just and reasonable net stranded costs and reiterates our commitment to working with the Commission and the other stakeholders to devise fair and effective ways to implement competitive restructuring in Virginia.

Sincerely,

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